

# Revising Multiemployer Plan Termination Insurance

A Guide to PBGC  
Recommendations  
to Congress



Pension Benefit Guaranty Corporation  
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## Preface

The Employee Retirement Income Security Act (ERISA) became law on September 2, 1974. One of its main purposes is to ensure workers against the loss of their pensions should their pension plan terminate.

To meet this purpose, the law set up a termination insurance program that is financed by premiums paid by covered plans. The Pension Benefit Guaranty Corporation (PBGC), also established by law, administers this insurance program.

The insurance program covers defined benefit plans which are plans that promise a specific benefit at retirement, such as a stated monthly pension. There are two types of defined benefit plans—

- single employer plans
- multiemployer plans.

Although the law required plans of both types to pay premiums immediately, automatic insurance of benefits in multiemployer plans was delayed until January 1, 1978. The delay was based on uncertainty about the appropriate design of multiemployer plan termination insurance. A number of experts had told Congress that because multiemployer plans do not depend on one employer for their survival, they would rarely terminate. Still others had pointed out that because of the unique characteristics of multiemployer plans, it was not possible at that time to be certain about the impact of the termination insurance rules on multiemployer plans. For these reasons, Congress decided to delay full inclusion of multiemployer plans under the insurance program. However, PBGC was given discretion to cover any terminations that occurred during the first 3 years of the program on a case-by-case basis. The three-year period of discretionary coverage was intended to allow time for actual experience to develop before termination insurance became automatic for multiemployer plans.

Studies and experience now show

clearly that multiemployer plans can and do terminate. In fact, the Corporation already has had to guarantee the pensions of 2650 workers who were covered under three terminated multiemployer plans covering the millinery industry in New York City. The net cost to the Corporation's multiemployer insurance fund was between \$5 million and \$6 million.

The Corporation has also agreed to cover a multiemployer plan covering milk delivery drivers in northern New Jersey. In this case, the Corporation assumed more than \$16 million in net unfunded guaranteed benefits. And most recently, the Corporation announced its decision to insure benefits provided under a Chicago based multiemployer plan covering electrotypers. Twelve other cases covering approximately 1800 participants are pending.

Based on Corporation studies, in as many as one out of every ten multiemployer plans, the cost of continuing the plan over the next decade may be more than the cost of termination under the law's current provisions. Should the plans choose to terminate, 1.3 million workers who have earned benefits under these plans could lose some of their benefits and most importantly the opportunity to earn additional pension credits. Their misfortune would also mean a net claim against the Corporation's multiemployer insurance fund that could reach a staggering \$4 billion!

Such costs would impose intolerable premiums on the remaining multiemployer plans—premiums which could precipitate still further terminations. This would undermine a prime purpose of the law, strengthening private pension plans.

With these concerns in mind, Congress extended the initial three-year delay of automatic insurance coverage to July 1, 1979 and directed the Corporation's staff to study the issue and come up with recommendations in advance of this deadline.

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## The Nature of Multiemployer Plans

Multiemployer plans usually cover employees working within an industry or craft in a specified geographic area. The plans are created and maintained under collective bargaining agreements negotiated between a union and employers.

Over the years, such plans have provided workers in the industries covered with a greater measure of retirement income security than single employer plans for two reasons. First, they provide workers with pension portability; employees retain their pension credits as they move from one covered employer to another. Second, they have generally protected an employee's benefits even though his or her particular employer might leave the plan. This latter feature means that an employer's contributions go to provide benefits for all workers covered by the plan, even people who never worked for that employer.

Multiemployer plans are governed by a board of trustees, with equal representation by unions and employers. Employers pay into the plan at an agreed upon rate, usually expressed in terms of so many cents-per-hour of covered employment. The trustees usually have no control over how much

money is paid into the pension fund. That's generally determined in the collective bargaining process. Rather, the trustees have normally taken the agreed upon contributions and established benefit levels based on assumptions about future employment levels, investment return, retirement patterns and turnover in the workforce.

This has proven to be a delicate process. In setting benefits, the trustees and their actuary generally assume that present conditions will continue in the future. But factors like employment levels in an industry can and do change dramatically over time. These changes mean that the funds projected to be available to pay benefits may not materialize.

Thus, the fiscal soundness of a multiemployer plan largely depends on a stable or growing number of employees in an industry. Where this is the case, it doesn't matter if a company drops out of a plan from time to time because chances are excellent that the company will either be replaced by another employer or that other employers will expand their employment. In either case, the employment base the plan can look to for contributions won't shrink!

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## The Effect of Declining Industries

Financial problems occur in multiemployer plans when an industry experiences a protracted decline in employment.

When employment declines, a smaller base of employees is asked to support the pension costs of an increasing number of retired workers. This increases employer labor costs. In highly competitive or marginally profitable situations, such increased costs may make the plan unattractive so that losses in the employment base are not replenished with new entrants. Carried to extremes, the increase in pension costs along with other labor cost increases may even contribute to the decline as employers go out of business or relocate.

Before ERISA was enacted, plan trustees could do a number of things

to control such escalating costs. They could defer funding, tighten vesting and eligibility rules, or, as a last resort, reduce benefits previously earned. ERISA greatly restricted these traditional remedies. Plans are required to fund at specified rates; benefit reductions have been virtually eliminated; minimum vesting standards have been imposed. As a result, unions and employers maintaining plans in declining industries today often face an unacceptable choice: agree to excessive and escalating contribution rates for existing benefits or terminate the plan.

The underlying problem, then, is one of declining industries. And, there are a number of these today:

- Home delivery of milk has declined because people buy their milk in supermarkets.

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- The drycleaning industry has declined because of the increasing use of washable, permanent press fabrics.
  - Employment levels in printing trades have declined because of increasing automation of production.
  - The maritime industry has been affected by foreign competition, automation and the growth of air transportation.
  - The apparel, shoe and leather industries have seen foreign competition cut significantly into domestic production.

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## What is Needed?

Basically, the current law has two major flaws that need to be corrected.

1. The law does not foster the survival of pension plans in declining industries. In fact, it does just the opposite. The escalation of costs may make termination more attractive than continuation for active employees as they watch even larger chunks of their wage package going to support retirement benefits that are oftentimes inadequate. And, the liability which the law currently imposes on those employers that stick with the plan until it fails creates pressure to get out early—clearly the wrong incentive.

*The rules need to be changed so that troubled plans can work their way out of trouble and survive.*

2. The current law insures against a voluntary act—plan termination. Thus, the sponsoring union and employers could agree to terminate a plan even though they have the financial ability to continue it. This is almost like paying off on fire insurance to home owners who set fire to their own house. *The only event the insurance fund should pay for is unavoidable plan insolvency.*

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## A Framework for Change

In developing its recommendations, the Corporation's staff talked at length with the Corporation's own Presidential Advisory Committee and with numerous other experts in the field. There was broad agreement that any workable solution must include the following ingredients:

1. *The law should not inhibit the give-and-take of collective bargaining.*  
Multiemployer plans are created and supported through collective bargaining. This process attempts to balance the needs and objectives of both employers and workers, and requires free give-and-take. The law should not inhibit this give-and-take by imposing disproportionate sanctions on either management or labor.

2. *Employers should be able to limit their obligations.*

Employers who continue their participation in a multiemployer pension plan should be assured that their financial obligations will not exceed the contribution rate negotiated under the collective bargaining agreement.

3. *Premiums for multiemployer pension plan insurance fund must be tolerable.*

Premium rates for insurance must be kept affordable. That will not be possible if pension plans terminate on a broad scale. If that happens, premiums will rise precipitously, placing a potentially untenable burden on ongoing plans and reducing their ability to provide adequate retirement benefits for their participants.

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# PBGC Recommendations

Based on these considerations, the Corporation has developed recommendations aimed at providing adequate benefit protection for workers covered under multiemployer plans at reasonable cost. The recommendations have two major objectives. (1) Make sure that a plan will have sufficient funds to pay benefits; and (2) Provide guarantees only for plan insolvencies that occur because of a sustained decline in covered employment. These recommendations and the seven key problems they address, are summarized in the paragraphs below.

## **Problem 1:**

### **The Law Allows Too Much Time to Fund Benefit Improvements and Fails to Require Fiscal Discipline.**

Plans now have 40 years to fund their benefit obligations. This is too long. Too much can happen in that time to produce asset deficiencies.

Covered employment within the industry may decline markedly because of changes in consumer demand, technology, foreign competition, or shifts to non-union labor.

Inflation or declining employment in an industry may impel unions to press for improved normal and early retirement benefits at the expense of sound funding of benefits already promised.

These circumstances can result in a major funding deficiency for a pension plan.

### **The Remedy: Require plans to fund new benefits over more realistic time periods.**

We therefore recommend that the time allowed for a pension plan to fund new benefit improvements be shortened from 40 years to 30 years.

### **Advantages:**

Financially healthy plans would be more likely to stay out of trouble.

Plans already headed for trouble would be less likely to get in deeper.

## **Problem 2:**

### **Even a 30-Year Funding Rule is Too Long for a Plan That's Headed for Insolvency**

Even a reduction to 30-year funding may not help a plan with a very large number of older participants. In such cases, payments of current pension benefits will deplete existing asset reserves and prevent the build up of new reserves necessary to secure future benefit payments.

### **The Remedy: For such plans, set the annual contribution requirement at an amount calculated to avoid insolvency.**

We therefore recommend an additional funding test that will require additional contributions, whenever the ordinary funding standards are inadequate to assure long-term solvency. This additional test would require that the funding target for each year be set at a level sufficient to fund the unfunded benefits of retirees over 10 years and the unfunded vested benefits of other participants over 25 years. PBGC studies show that this test affects only plans in financially precarious positions.

### **Advantages:**

The Minimum Contribution Requirement would avoid plan insolvency unless there were a sustained decline in employment.

The Minimum Contribution Requirement acts as a restraint on imprudent benefit promises by requiring that contributions be high enough to fund such promises over a realistic period.

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### **Problem 3:**

#### **The Law Presents Unions and Employers in Declining Industries with Two Unacceptable Choices: Raise Contributions Excessively or Terminate.**

When contributions were inadequate prior to ERISA, trustees could, as a last resort, head off insolvency by simply reducing benefits. But the law has all but eliminated this last resort by severely limiting reductions in benefits already earned.

This leaves the parties to collective bargaining with an impossible choice: raise contributions to uneconomic levels or terminate the plan. In effect, this amounts to a choice between a lingering or a quick death.

#### **The Remedy:**

##### **Give trustees of plans facing insolvency the leeway to "reorganize" plan benefits to levels consistent with an affordable contribution rate.**

We therefore recommend that, if higher contributions cannot be negotiated, trustees of severely troubled plans be permitted to eliminate benefit improvements put into place during the preceding 5 years to lessen the funding burden.

#### **Advantage:**

This will remove some of the cost pressures that lead to collapse.

### **Problem 4:**

#### **Some Plans Can't Control Costs Just by Reorganizing Benefits.**

Even if they reorganize, some plans in declining industries will still be faced with very high and escalating pension costs. As covered employment declines, the funding burden must be spread over even fewer active employees, pushing the contribution per employee to intolerable levels. In the milk workers' plan, for example, annual contributions were almost \$2,000 per year for a maximum benefit of only \$3,600 per year payable at retirement. In the anthracite coal plan, annual contributions are approxi-

mately \$1,500 for a \$360 per year retirement benefit. These extreme conditions tend to occur whenever the number of inactive workers and pensioners exceeds the number of active workers.

#### **The Remedy:**

##### **Provide relief from escalating plan costs whenever the number of inactive workers and pensioners exceeds the number of active workers, with insurance payable in the event the plan cannot meet benefit payments.**

We therefore recommend that the funding standards for plans in reorganization be modified whenever pensioners and inactive workers exceed active workers. The relief would be in the form of a funding credit based on one-half of the benefit payments to excess pensioners.

If a plan's employment base continues to decline long enough, that plan will eventually become unable to pay even the guaranteed level of benefits. In that case, and in that case only, we recommend that insurance funds be available to make up the difference between the guaranteed level of benefits and the level supportable by contributions from continuing employers.

Further, we recommend that employers that remain with their plan be obligated only to continue contributions at the rate in effect when the plan became insolvent. Any further declines in employment would be covered by insurance.

#### **Advantages:**

PBGC involvement and assistance would be deferred until absolutely necessary, which will result in significant premium savings.

Administrative responsibilities would largely remain with the plan, thereby greatly simplifying administration of the guarantee program.

Insulating employers who remain with the plan from liability for plan failure should encourage employers to continue their participation in the plan.

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**Problem 5:****High Guarantees in the Law May Create Runaway Insurance Costs.**

Pension benefits guaranteed by the present law are quite high and cover most vested benefits provided by many multiemployer plans. In the case of a troubled plan, such high guarantees provide little incentive to avoid plan insolvency and the eventual need for PBGC assistance. The prospect of high guarantees may actually invite benefit improvements even where the industry outlook is gloomy. The net effect is to expose the insurance program and premium payers to potentially unreasonable excessive and destructive costs.

**The Remedy:  
Reduce the guarantees.**

We therefore recommend that the insurance program guarantee be structured to provide full guarantees for modest benefit levels and only partial guarantees for additional benefits. Specifically, we recommend a guarantee of 100% of the first \$5 per month per year of service and 60% of the next \$15 per month per year of service. Thus, a worker with 20 years of service and a benefit of \$100 per month or less would receive a full guarantee. A worker with 20 years of service and a \$200 monthly benefit would have a guarantee of \$160, 80% of the benefit.

We also recommend no guarantee for benefits resulting from benefit increases made during the five years preceding insolvency.

**Advantages:**

Lower guarantees create an incentive to avoid insolvency, since insolvency would result in benefit reductions.

The recommended guarantee structure weighs the guarantee heavily toward average and lower than average benefit levels; therefore, the multiemployer plan universe will not be charged premiums to subsidize overly generous benefits.

Lower guarantees during the initial years of the program would reduce the risk of excessive costs and provide a

trial period for the program. Based on the experience during this period, the guarantee level could then be re-evaluated.

**Problem 6:****The Current Rules Governing an Employer's Withdrawal from a Plan Fail to Protect Participants, Remaining Employers and the PBGC from the Costs of Voluntary Employer Withdrawals.**

If an employer withdraws from a pension plan, its share of the funding burden must be picked up by remaining employers. Thus, withdrawals add to the escalation in funding costs. The current statutory rules impose liability on termination but not upon withdrawal, except in the case of an employer that makes more than 10% of the total contributions to the plan.

But even such substantial employers are not required to compensate the plan upon withdrawal. Current rules require only that they put money in escrow or post a bond when they leave a plan for their potential termination liability. The money in escrow or bond does not help fund the plan. Thus, any employer—small or large—can escape liability altogether if the plan terminates more than five years after his withdrawal. Consequently, if an employer thinks a plan is shaky, it is to that employer's advantage to withdraw as soon as possible.

These rules have the effect of penalizing employers who remain with a plan until it terminates and rewarding those who leave the plan early, an effect just the opposite of what the law intended.

**The Remedy:  
Require employers who leave a plan to continue to make periodic payments to fund their liabilities.**

We therefore recommend that a withdrawing employer be required to continue contributions to the plan until it has funded a proportionate share of the unfunded vested pension liabilities.

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Further, we recommend that withdrawing employers pay what they owe directly to the pension plan.

Finally, because in the construction industry the withdrawal of an employer does not remove jobs from the plan's employment base unless that employer continues working in that area, we recommend that liability in the construction industry be limited to that instance.

**Advantages:**

Employers would have less incentive to pull out of a pension plan.

The pension plan would be fairly compensated over time for its loss when an employer does pull out; hence, the burden on remaining employees and employers would not be increased as a result of the withdrawal.

The plan, not PBGC, would administer withdrawal liability.

**Problem 7:**

**The Current Employer Liability Rules Undermine Multiemployer Plans.**

Under existing law, employers that remain with a plan until it terminates are liable to PBGC for unfunded guaranteed benefits up to 30% of each employer's net worth. It is one thing to ask an employer to finance a declining pension plan through negotiated contributions. In that case, the pension cost increases can be compensated for by concessions in other areas. The pension cost is simply another element of an employer's labor cost and can be factored into pricing and manning decisions just like any other cost.

It is, however, quite another thing to impose liability on an employer for a multiemployer plan termination above and beyond the negotiated rate. This liability is contingent and large, and generally outside the individual employer's control. Such liability, in effect, makes each employer in a plan responsible for other employer's actions and makes each employer an underwriter of the industry's economic survival. Yet, that is what ERISA's current liability provisions do; it is for that

reason that employers and unions alike believe that employer liability as it currently exists threatens the survival of multiemployer plans. But, the absence of any restraint on plan abandonment by unions or employers would place great risks on either retirees or the insurance program. If the parties were free to create an insurable event and have benefits guaranteed merely by deciding not to continue funding the plan, large costs would be transferred to the insurance system even though the union and employers maintaining the plan could afford to continue it. On the other hand, if such abandonment were not an insurable event, retired and other participants would be subject to loss of their earned retirement pensions.

**The Remedy:**

**Require unions and employers that terminate a plan to complete funding vested benefits.**

We therefore recommend that ERISA's funding requirements continue to apply to the vested benefits employees have earned under the plan until these benefits are fully funded.

We also recommend that the reorganization rules apply to a terminated plan, and that PBGC assistance be available if the plan becomes insolvent.

**Advantages:**

This would protect participants, especially retirees and older active participants from unnecessary benefit losses. Benefits could be reduced only if the terminated plan entered reorganization or became insolvent.

It avoids lump-sum termination liability. The parties would be required to continue funding, so that pension costs would remain a part of collective bargaining.

Since the reorganization rules apply, remaining employers would be protected from ever-escalating plan costs if the terminated plan should suffer a prolonged decline in employment.

It limits PBGC involvement to unavoidable plan insolvency.



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## An Urgent Agenda

Multiemployer pension plans may be the only way millions of American workers can earn vested retirement benefits in the private sector. In many industries, such as construction, the nature of the work causes workers to change employers often. For these workers, portability of their pension benefits is absolutely necessary.

But for multiemployer plans to survive and prosper, workers must know that they can count on the retirement benefits they are earning. Through development of a meaningful insurance program for multiemployer pension plans, workers are guaranteed that they will be able to receive the pen-

sions they counted on to provide adequate retirement income even if their plan should fail.

In the interests of both employers and employees, it is urgent that the Employee Retirement Income Security Act work as Congress intended.

For further information concerning the recommendations for revising the Multiemployer Termination Insurance Program, the following PBGC staff members may be contacted:

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